

Executive Summary

Third Quarter FY2006

General Fund receipts totaled \$1,854.5 million for the third quarter of fiscal year 2006 (FY06), increasing from FY05 by 4.2 percent. This represents \$74.2 million more than reported in the same period one year earlier. The Road Fund fell by 0.8 percent during the third quarter, and economic growth as measured by Kentucky personal income was up by 5.7 percent.

Performance in the General Fund categories for the third quarter was affected not only by economic conditions but also by changes enacted in 2005 by HB 272 (*JOBS for Kentucky*). Sales and use tax revenues were up by 5.7 percent. Individual income tax receipts fell by 10.4 percent, reflecting tax cuts that began to take effect in July. Corporation income and license taxes posted sharp growth of 65.3 percent reflecting both the strength of the economy and the shift in revenues away from individual income taxes and into the corporation income tax for pass-through entities.

Coal severance taxes rose by 32.3 percent continuing their strong recent performance. Cigarette taxes, boosted by

an increase in the rate, were up by 958.4 percent in the third quarter of FY06. Property taxes were 7.8 percent lower than a year earlier, affected by timing differences in collection of some accounts.

During the third quarter of FY06, lottery revenues grew by 54.5 percent compared to the third quarter of FY05. Reported growth in receipts for this quarter was affected by unusually low dividends paid by the Lottery to the General Fund a year earlier. All other receipts combined for a decline of 1.8 percent.

Road Fund receipts were boosted by a recalculation of the statutory rate of motor fuels taxes, which are tied to the wholesale price of motor fuels. For the third quarter, the Road Fund declined by 0.8 percent. Motor fuels taxes rose by 2.6 percent, while motor vehicle usage tax receipts fell by 10.9 percent as the continuing high oil prices deterred potential car buyers.

Weight distance tax revenues rose by 2.2 percent, and motor vehicle license tax revenues fell by 3.6 percent. Motor vehicle operator's license tax rose by 198.1 percent due to an in-

crease in drivers license fees charged by the state.



The U.S. economy as measured by real gross domestic product (GDP) was estimated to have expanded by 4.9 percent in the third quarter of FY06. Personal income also rose by a healthy 6.3 percent.

Kentucky's economy as measured by personal income grew by 5.7 percent over the same period one year earlier. Employment in the state grew by 1.8 percent as 31,800 jobs were added to the payroll during the third quarter.

The interim forecast for the General Fund expects revenues to rise by 5.0 percent in the final quarter of FY06. Total revenues for the entire fiscal year are forecasted to reach \$8,257.1 million, which is \$19.8 million more than the official estimate approved by the Consensus Forecasting Group in December 2005 and modified by the 2006 General Assembly.

Among the major accounts, the outlook for the final quarter of FY06 is for sales and use tax revenues to rise by 2.6 percent, the individual income tax to decline by 8.5 percent, corporation income and license taxes to grow by 25.1 percent, and coal severance tax receipts to expand by 27.9 percent.

The cigarette tax was most affected by an increase in the rate from three cents per pack to 30 cents, and revenues are estimated to grow by 108.3 percent in the last three months of FY06. Property tax receipts will fall by 0.3 percent, and dividend payments from the lottery should rise by

32.5 percent. "Other" taxes and revenues will combine for an increase of 32.2 percent during the final quarter due primarily to new taxes created in *JOBS for Kentucky* on telecommunications services. For the first two quarters of FY07, General Fund receipts are forecasted to rise by 2.5 percent.

The interim outlook for the Road Fund anticipates an increase in revenues of 3.6 percent for the last quarter of FY06. This is \$8.0 million below the official consensus revenue estimate of December 20. (No changes to the consensus forecast for FY06 were enacted by the 2006 General Assembly.) Motor fuels taxes will grow by 9.1 percent chiefly due to the higher rate on gasoline and other motor fuels. Motor vehicle usage tax collections are expected to decline by 6.3 percent, and motor vehicle operators' license fees are projected to expand by 243.8 percent because of an increase in the fee effective this fiscal year. For the first two quarters of FY07, the Road Fund should grow by 3.0 percent.

The outlook for the national economy foresees real GDP growth of 3.5 percent over the remainder of FY06, and personal income growth of 6.2 percent. In Kentucky, personal income is expected to rise by 5.6 percent, while employment should rise by 1.5 percent or 27,000 jobs. In the first two quarters of FY07, Kentucky personal income should continue to grow at a similar rate of 6.2 percent, and employment growth should continue at 1.3 percent.

Revenue Receipts

Third Quarter FY2006

General Fund

The third quarter of FY06 experienced moderate growth following a robust second quarter of this fiscal year. Third-quarter growth rates were boosted by increased receipts from the corporation income, cigarette, and coal severance taxes. Receipts in the third quarter totaled \$1,854.5 million compared to \$1,780.3 million received in the third quarter of FY05. The resulting growth rate was 4.2 percent, and compares to a growth rate of 9.4 percent for the same quarter last year. Collections in the major revenue categories are shown in summary form in Table 1. Detailed information on these and other accounts is available in the Appendix.

Variations in the quarterly receipts are often affected by differences in the timing of payments into revenue accounts. While timing differences were not as prevalent as in the past, property tax receipts continue to record fluctuations because of these differences.

Table 1
Summary General Fund Receipts
Third Quarter, FY06
(million \$)

	FY06	FY05	Diff (\$)	Diff (%)
Sales and Use	684.6	647.8	36.8	5.7
Individual Income	591.4	660.2	-68.8	-10.4
Corp. Inc. & License	125.5	75.9	49.6	65.3
Coal Severance	57.8	43.7	14.1	32.3
Cigarette Taxes	41.9	4.0	37.9	958.4
Property	119.9	130.0	-10.1	-7.8
Lottery	51.0	33.0	18.0	54.5
Other	<u>182.4</u>	<u>185.7</u>	<u>-3.3</u>	<u>-1.8</u>
TOTAL	1,854.5	1,780.3	74.2	4.2

Total sales and use tax receipts for the quarter were \$684.6 million, compared to \$647.8 million in the third quarter of FY05. The result is a growth rate of 5.7 percent and lags the 8.2 percent growth for the third quarter of last year.

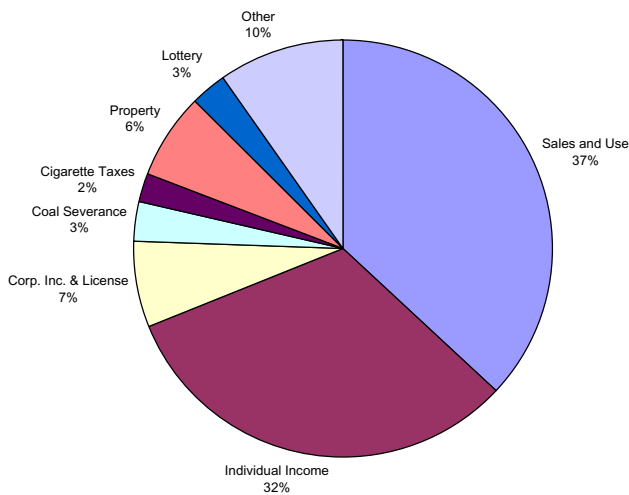
Individual income tax posted receipts of \$591.4 million, compared to last year's third quarter receipts of \$660.2 million. The result was a decline of 10.4 percent, and compares to a growth rate of 16.5 percent for the third quarter of last year. The decline in this revenue source is due to tax cuts and changes in law that now require limited-liability entities to file under the corporation income tax rather than under the individual income tax.

Combined **corporation income and license tax** receipts grew strongly in the third quarter of the fiscal year. Revenues of \$125.5 million were 65.3 percent higher than year-earlier figures of \$75.9 million. The rise in corporation income tax revenues is the mirror effect of the shift in reporting by limited liability entities.

Coal severance tax revenue continued to grow in the third quarter, with receipts up by 32.3 percent. Collections of \$57.8 million compare to the FY05 third quarter total of \$43.7 million.

Cigarette tax receipts of \$41.9 million in the third quarter of FY06 exceeded last year's total of \$4.0 million. The \$37.9 million increase was the result of tax increases enacted by the 2005 General Assembly.

Figure 1
Third Quarter, FY06
General Fund Receipts



Third-quarter **property tax** receipts posted revenues that were 7.8 percent lower than the third quarter of FY05. FY06 third-quarter receipts of \$119.9 million compare with \$130.0 million from the third quarter of FY05.

Lottery receipts were \$51.0 million, 54.5 percent more than last year's third quarter total of \$33.0 million. The \$18.0 million increase was the result of a "bonus" dividend arising from strong Powerball ticket sales.

The "**all other**" category, which represents the remaining accounts of the General Fund, fell 1.8 percent in the third quarter. Third quarter receipts for FY06 were \$182.4 million and compare to \$185.7 million in FY05. A drop in inheritance tax revenues was principally responsible for the decline.

Road Fund

The Road Fund reported a decrease of 0.8 percent in the third quarter of FY06. Receipts totaled \$283.0 million and compare

to \$285.1 million from the third quarter of last year. Summary data are contained in Table 2 and detailed data are shown in the Appendix.

Motor fuels tax receipts grew at a rate of 2.6 percent during the third quarter due to the formula-driven increase in the tax rate tied to the price of gasoline. Receipts were \$118.3 million and compare to \$115.3 million collected during the third quarter of last year.

Motor vehicle usage tax revenues declined in the third quarter, with receipts down by 10.9 percent. Receipts during the third quarter of FY06 totaled \$89.4 million and compare to \$100.3 million collected during the same period last year.

Motor vehicle license tax receipts decreased 3.6 percent in the third quarter of FY06 to \$28.4 million.

Motor vehicle operators license tax receipts were \$3.9 million in the third quarter of FY06. The 198.1 percent increase over FY05 third quarter receipts was the result of an increase in license fees.

Weight distance tax receipts of \$21.2 million represent a 2.2 percent increase over receipts of \$20.8 million during the third quarter of FY05.

Investment receipts of \$1.8 million were 199.9 percent higher than the total collected in the third quarter of FY05.

The remainder of the accounts in the Road Fund combined for an increase of 15.6 percent from a year earlier. In the "**all other**" category, revenues of \$20.0 million compare to \$17.3 million in the third quarter of FY05.

Revenue Receipts

Figure 2
Third Quarter, FY06
Road Fund Receipts

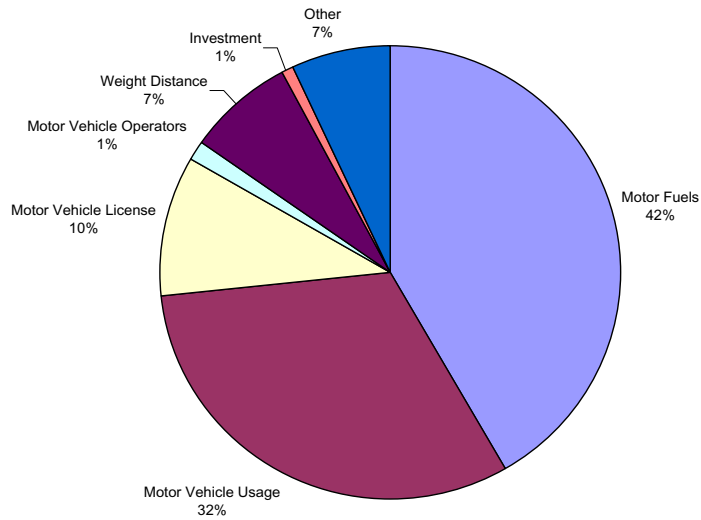


Table 2
Summary Road Fund Receipts
Third Quarter, FY06
(million \$)

	FY06	FY05	Diff (\$)	Diff (%)
Motor Fuels	118.3	115.3	3.0	2.6
Motor Vehicle Usage	89.4	100.3	-10.9	-10.9
Motor Vehicle License	28.4	29.5	-1.1	-3.6
Motor Veh Operators	3.9	1.3	2.6	198.1
Weight Distance	21.2	20.8	0.4	2.2
Investment Income	1.8	0.6	1.2	199.9
Other	<u>20.0</u>	<u>17.3</u>	<u>2.7</u>	<u>15.6</u>
TOTAL	283.0	285.1	-2.1	-0.8

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The Economy

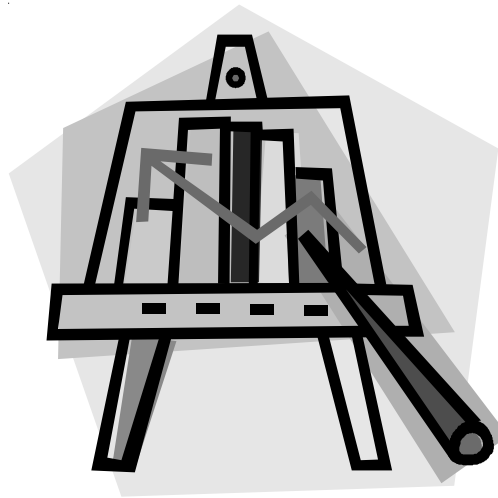
Third Quarter FY2006

NATIONAL ECONOMY

The national economy is measured by the real gross domestic product (GDP). This is an inflation-adjusted measure of the total output of goods and services produced in the United States. Real GDP is estimated to have increased by a robust 4.9 percent in the third quarter. This strong showing is partly a rebound from the tepid growth of 1.6 percent in the previous quarter.

The strength of the domestic economy is derived from the American consumer. Consumption expenditures account for about two-thirds of real GDP. Real consumption was up 5.2 percent during the third quarter following an increase of just 1.2 percent in the previous quarter. The slow growth in the October-to-December 2005 quarter was due largely to the decline in motor vehicles sales (down 42.7 percent) caused by the Hurricane Katrina-related increase in fuel prices. This subsequently caused a slowdown in total consumption and real GDP. In the third quarter of FY06, however, the consumption of durable goods was up strongly by 17.5 percent, as motor vehicle sales rebounded. The strong housing market also helped durable goods by keeping up

the growth in furniture sales. Consumption of furniture was up 11.9 percent in the third quarter following a similar increase in growth of 11.7 percent in the previous period. Consumption of nondurable goods was up 6.8 percent. Over the last year, nondurable consumption has grown steadily at about this rate. The growth in consumption was in the areas of gasoline (up 8.6 percent) and food (up 7.1 percent). The strong growth in food consumption was probably a secondary effect from the rise in fuel prices and the associated increase in transportation costs. Services constitute a little over one-half of all consumption and about 35 percent of total GDP. The consumption of services increased by 2.2 percent in the third quarter, compared to 3.0 percent in the previous quarter. Most of the increase came from the area of personal and business services.



Investment spending continues to improve and indicates that the economic recovery is here to stay. Total investment comprises close to a fifth of real GDP and is usually sensitive to both interest rates and future expansion opportunities. The investment component of GDP increased by 9.5 percent during the third quarter after posting robust growth of 14.8 percent in the previous quarter. Investment in equipment and software continued to show strong growth of 11.3 percent.

Government spending constitutes 17 percent of GDP and was up 2.4 percent. The state and local government component was up just 1.2 percent primarily as a result of revenue

constraints. Defense currently constitutes about two-thirds of federal government purchases. During January to March 2006 defense spending was up 8.3 percent. In spite of the weak dollar, imports grew by 12.2 percent while exports were up 11.7 percent.

The Governor's Office for Economic Analysis monitors industrial production because it is a measure of the output of heavy industries like mining and manufacturing. These industries continue to play a vital role in Kentucky's economy. Industrial production is a raw measure of output, comprised of only the final products. Total industrial production was up a robust 7.1 percent during the third quarter compared to 3.8 percent a year ago. Most of the gain was from oil and gas extraction and coal mining. All other major areas of production were up with the exception of textile

mills and apparel. The University of Michigan Consumer Sentiment index for the third quarter was at 88.5 compared to 94.1 a year ago. This drop in consumer confidence is tied directly to the spike in oil prices. During the period January to March 2006 oil prices averaged \$64 per barrel compared to \$50 a year ago.

Personal income, which is a measure of spending power, was \$10,650.1 billion (annualized) in the third quarter of FY06, a growth rate of 6.3 percent from the previous quarter. Real disposable income was up 3.8 percent. Inflation has been on the rise in response to high energy prices. The U.S. Department of Commerce has reported a slight moderation in inflation from 3.2 percent in the second quarter to 2.2 percent in the third quarter.

The unemployment rate dropped slightly from 4.9 percent in the second quarter to 4.8 percent in the third quarter. Nonfarm employment posted a strong gain of 1.8 percent during the third quarter. The largest gains were posted in mining and construction, and the slimmest increase was in manufacturing, up 0.4 percent from the previous quarter, but down 0.3 percent from a year ago.

STATE ECONOMY

According to data released in March the Kentucky economy passed a milestone in the second quarter of FY06 (October to December 2005): nonfarm employment levels surpassed the previous high established just before the recession in March 2000. It took almost six years to recover the jobs lost during the recession. During the third quarter, key measures like employment and income have grown strongly, indicating that Kentucky is on a steady growth path.

Table 3
National Economic Indicators
Third Quarter, FY06*

	FY06:2	FY06:3	SAAR** FY06:2 to FY06:3
Real GDP (bil 2000 \$)	11,247.6	11,383.9	4.9
Personal Income (bil \$)	10,487.7	10,650.1	6.3
Real Disposable Income (bil 2000 \$)	8,213.6	8,290.7	3.8
Consumer Price Index (annual percent change)	3.2	1.2	-
Industrial Production (annual percent change)	5.6	7.1	-
Civilian Labor Force (millions)	148.1	148.1	-0.1
Total Nonagricultural Employment (millions)	134.2	134.8	1.8
Manufacturing Employment (millions)	14.2	14.2	0.4
Unemployment Rate (percent)	4.9	4.8	-

Sources: Global Insight, Inc., and U.S. Dept. of Commerce, Bureau of Economic Analysis.

* Data for FY06:3 are March 2006 estimates and cover the period January to March 2006.

** Seasonally adjusted annual percent growth rate.

Kentucky's personal income is estimated to be \$123.4 billion in the third quarter of FY06, an increase of 5.7 percent from a year ago. U.S. personal income grew at the same rate during that period. Wages and salaries constitute a little over half of personal income. Income derived from wages and salaries is estimated to have grown by 5.4 percent, compared to just 4.9 percent nationally.

Employment data is commonly used to gauge the strength of the state's economy, primarily because of its timely availability and its impact on consumer spending and confidence. Kentucky gained approximately 31,800 jobs during the third quarter compared to a year ago. This growth of 1.8 percent is slightly stronger than the 1.6 percent growth in national employment during the same period.

Manufacturing jobs in Kentucky have been the hardest hit by the recession. However, during the third quarter manufacturing employment increased by 1.5 percent resulting for a net gain of 3,900 jobs. Na-

tionally, manufacturing employment declined by 0.3 percent during the same period. (About half of the increased growth in Kentucky's manufacturing employment is due to an anomaly in the data collected a year ago. The strong 1.5 percent growth is not expected to continue into the near future.) In spite of high crude oil prices, the transportation equipment manufacturing industry posted strong gains the third quarter.

A little over one-third of Kentucky's nonagricultural jobs are in the services sector. The broad service-related industries are part of four newly categorized areas, called super sectors: business services, educational and health services, leisure and hospitality services, and other services. Overall employment in services was up 1.8 percent with the strongest gains in business services. The business service category is dominated by temporary employment services, and it is possible that the strong growth in this sector reflects a reluctance of businesses to hire permanent employees.

Table 4
Selected Kentucky Economic Indicators
Seasonally Adjusted Data

	FY05:3	FY06:3	% Chg*
Total Personal Income (\$ millions)	116,738	123,443	5.7%
Wage & Salary Income (\$ millions)	64,167	67,604	5.4%
Total Nonagricultural Employment	1,814.0	1,845.8	1.8%
Contract Construction	83.9	86.2	2.7%
Mining	20.5	22.4	9.6%
Manufacturing	262.9	266.8	1.5%
Trade, Transportation & Utilities	377.0	381.5	1.2%
Information	28.7	29.3	2.0%
Finance	87.2	87.8	0.7%
Business Services	169.3	175.1	3.4%
Educational and Health Services	233.3	237.7	1.9%
Leisure and Hospitality Services	163.4	166.8	2.1%
Other Services	76.5	77.5	1.4%
Government	311.4	314.7	1.1%

* Seasonally adjusted rate from a year ago.

Source: GOEA's Macromodel of Kentucky, March 2006.

The strongest percentage gains were in mining (up 9.6 percent) and construction (up 2.7 percent). Employment in coal mining had declined steadily for eighteen years. However, the increase in energy prices driven by huge demands from developing economies has caused an increased demand for coal and has led to a spurt in employment. Over the last five years historically low mortgage rates have resulted in a rapidly expanding housing market nationally. This phenomenon is somewhat muted in Kentucky, but has been enough to sustain high levels of employment in construction.

Figure 3
Personal Income: KY vs. U.S.
(Index FY00 = 100)

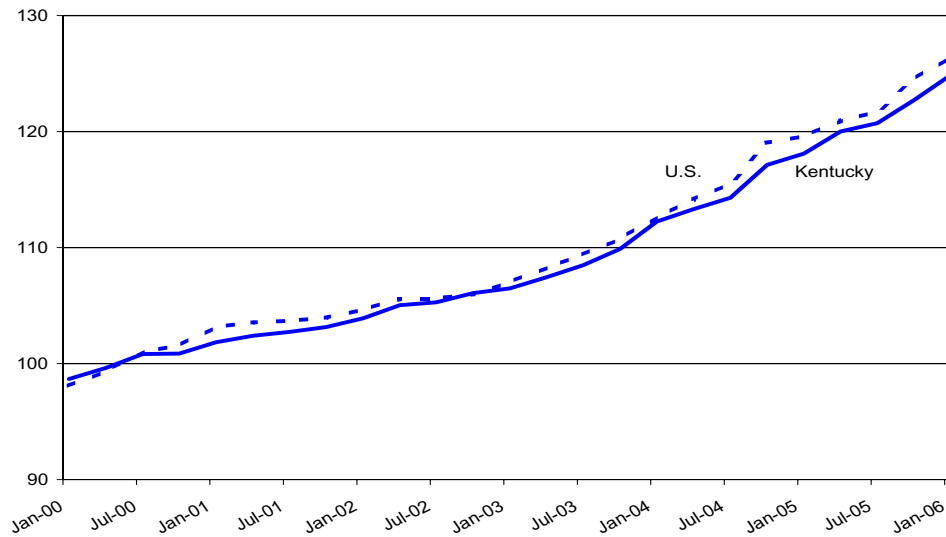
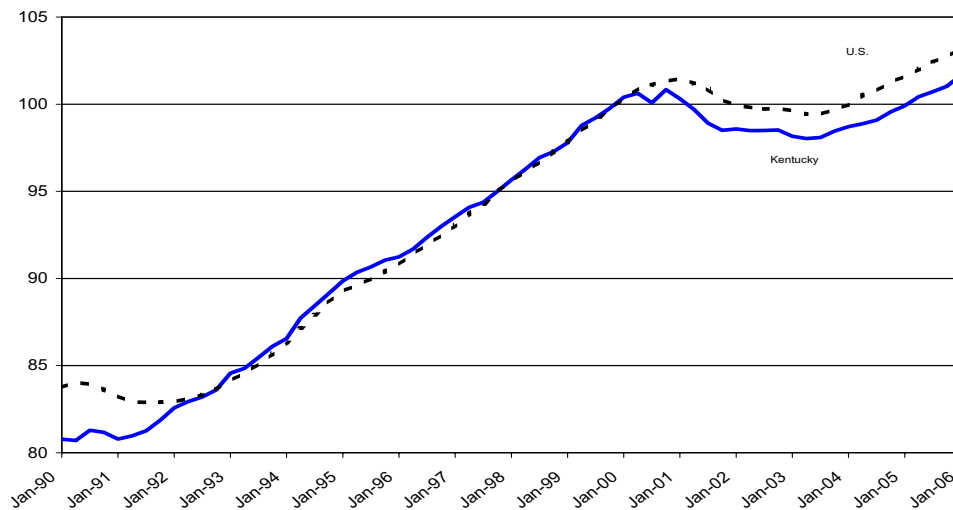


Figure 4
Nonfarm Employment Growth: KY vs. U.S.
(Index FY00 = 100)



Interim Outlook

Fourth Quarter, FY06 & First and Second Quarters FY07

GENERAL FUND

Projected General Fund revenues for the next three quarters are shown in Table 5. The interim forecast incorporates the fiscal impact of legislation enacted by the 2006 General Assembly. General Fund revenues were \$6,008.8 million in the first three quarters of FY06, a growth rate of 9.2 percent from the same period a year ago. General Fund revenues are anticipated to total \$2,248.2 million in the fourth quarter of FY06, yielding a growth rate of 5.0 percent. For the entire fiscal year, total General Fund collections are expected to grow 8.0 percent, with total revenues of \$8,257.1 million. Compared to the official revenue estimates approved by the 2006 General Assembly, General Fund revenues are now projected to be \$19.8 million higher in FY06.

Anticipated revenues for the first two quarters of FY07 will be \$4,258.2 million, corresponding to a growth rate of 2.5 percent from the previous fiscal year. Growth is expected to be strongest in the coal severance tax, lottery receipts, and the "Other" category.

Total sales and use tax receipts for the first three quarters of FY06 were \$2,053.1 million, representing an increase of 6.1 percent from the same period a year ago. The projected rate of growth for the remaining quarter of FY06 is 2.6 percent. Total sales and use tax receipts for the fiscal year are forecast to be \$2,730.0 million, an increase of \$23.4 million over the official estimate. In the first two quarters of FY07, the sales and use tax will grow by 3.7 percent.

Table 5
General Fund: Interim Forecast
(millions of dollars)
April 2006

	FY06 Quarters 1, 2 & 3		FY06 Quarter 4		FY06 Full Year		FY07 Quarters 1 & 2	
	% Chg		% Chg		% Chg		% Chg	
	Actual	Year Ago	Interim Estimate	Year Ago	Interim Estimate	Year Ago	Interim Estimate	Year Ago
Sales & Use	2,053.1	6.1	676.9	2.6	2,730.0	5.2	1,419.6	3.7
Individual Income	2,105.9	-1.6	819.6	-8.5	2,925.5	-3.6	1,559.3	3.0
Corporation Inc. & Lic.	563.7	75.0	363.5	25.1	927.2	51.3	396.9	-9.4
Coal Severance	163.2	24.9	68.7	27.9	231.9	25.8	134.4	27.5
Cigarette Tax	135.7	1,042.8	45.4	108.3	181.1	437.9	83.3	-15.1
Property	444.8	5.5	50.8	-0.3	495.7	4.9	312.3	-3.9
Lottery	128.0	6.9	55.0	32.5	183.0	13.5	91.0	18.2
Other	414.4	-1.8	168.3	32.2	582.7	6.1	261.4	14.8
General Fund	6,008.8	9.2	2,248.2	5.0	8,257.1	8.0	4,258.2	2.5

The interim forecast for the individual income tax calls for a drop of 8.5 percent for the remainder of FY06, amounting to collections of \$819.6 million in the final quarter of the fiscal year. The individual income tax fell by 1.6 percent in the first three quarters of FY06. For the entire fiscal year, individual income tax revenues are projected to decline by 3.6 percent. Compared to the official estimate, individual income tax receipts are unchanged at \$2,925.5 million. In the first half of FY07, individual income tax receipts are expected to rise by 3.0 percent to \$1,559.3 million.

The outlook for corporation income and license taxes is for an increase of 25.1 percent in the final three months of FY06, representing collections of \$363.5 million. These anticipated collections will bring the FY06 total to \$927.2 million, an increase of 51.3 percent from FY05. Corporation tax revenues are affected by legislative changes enacted in HB 272 (*JOBS for Kentucky*). Total corporation income and license tax receipts are forecast to be \$1.5 million lower than the official consensus forecast. Corporate tax receipts are ex-

pected to fall 9.4 percent in the first six months of FY07 due to the repeal of the license tax.

The coal severance tax continued its recent robust growth in the first three quarters of FY06. Growth for the period has been 24.9 percent and will continue into the final quarter of the fiscal year with receipts increasing 27.9 percent. Total FY06 collections will total \$231.9 million, an increase of \$17.6 million over the official estimate. In the first two quarters of FY07, coal tax receipts will grow by 27.5 percent to \$134.4 million.

Cigarette taxes were increased by the 2005 General Assembly, which raised the rate on a pack from 3 cents to 30 cents. (Only 29 cents of the tax accrues to the General Fund). Additionally, a floor stocks tax was imposed on cigarette inventories. In the first three quarters of FY06, cigarette tax collections totaled \$135.7 million, including the floor stocks tax. The outlook for the remaining three months of the fiscal year is for \$45.4 million in revenue, with a corresponding growth rate of 108.3 percent. Overall for the fiscal year, cigarette tax receipts are forecast to increase 437.9 percent to \$181.1 million. Cigarette tax receipts are forecast to fall 15.1 percent in the first half of FY07 due to the inclusion of the floor stocks tax in FY06 but not FY07 receipts.

Property tax revenues totaled \$444.8 million in the first three quarters of FY06, representing growth of 5.5 percent from a year earlier. Receipts in property tax are sensitive to timing of payments, and in the first nine months of the fiscal year payments of real property taxes were received earlier than in the previous year. It is expected that in the final quarter of FY06, property tax revenues will fall 0.3 percent to \$50.8 million. Total property tax re-

Table 6
FY06 Interim General Fund Revenue Forecast
Compared to Official Estimate
(million \$)

	<u>Interim</u> <u>Estimate</u>	<u>Official</u> <u>Estimate*</u>	<u>Dif</u>
Sales & Use	2,730.0	2,706.6	23.4
Individual Income	2,925.5	2,925.5	0.0
Corp Inc. & Lic.	927.2	928.7	-1.5
Coal Severance	231.9	214.3	17.6
Cigarette	181.1	181.5	-0.4
Property	495.6	495.7	-0.1
Lottery	183.0	190.0	-7.0
Other	<u>582.7</u>	<u>594.9</u>	<u>-12.2</u>
General Fund	8,257.0	8,237.2	19.8

*The December 2005 consensus revenue estimate was modified by the 2006 General Assembly to include \$20 million in additional lottery receipts and approximately \$1.1 million in "other" revenue.

ceipts for FY06 are estimated to be \$495.7 million, an increase of 4.9 percent. In the first two quarters of FY07, property tax receipts will fall by 3.9 percent due to timing differences.

Lottery revenues rose 6.9 percent in the first nine months of FY06. In the final quarter, lottery revenues are expected to rise by 32.5 percent to \$55.0 million. For the entire fiscal year, lottery receipts are forecast to be \$183.0 million, \$7.0 million below the official forecast as modified by the 2006 General Assembly. Lottery receipts are expected to increase 18.2 percent in the first six months of FY07.

The “other” category contains estimates for several of the smaller revenue sources not otherwise classified. For the first nine months of FY06, receipts in this category fell 1.8 percent compared to the prior year. During the last quarter of FY06 this category should experience growth of 32.2 percent, bringing total fiscal year receipts to \$582.7 million. Strong growth in this account is anticipated due to several measures: the imposition of telecommunications excise and gross receipts taxes, increased enforcement, and redirecting aban-

doned property receipts to the General Fund. Total FY06 receipts are forecast to be \$12.2 million lower than the official revenue estimate.

ROAD FUND

Road Fund revenues are forecasted to grow by 3.6 percent over the final three months of FY06 and 3.0 percent in the first two quarters of FY07 as shown on Table 7. This forecast is \$8.0 million lower than the official revised consensus revenue estimates. The estimate for the first two quarters of FY07 includes an additional \$300,000 from enhanced enforcement efforts.

Motor fuels tax receipts grew by 7.6 percent in the first three quarters of FY06 to \$392.1 million. This is principally due to a change in forecasted gasoline prices and its effect on the statutory rate of the motor fuels tax. Growth in this account will continue into the final quarter of the fiscal year with receipts of \$137.9 million, a growth rate of 9.1 percent. Motor fuel tax receipts are expected to exceed the official revenue estimate by \$1.5 million.

Table 7
Road Fund: Interim Forecast
(millions of dollars)
April 2006

	FY06 Quarters 1, 2 & 3		FY06 Quarter 4		FY06 Full Year		FY07 Quarters 1 & 2	
	% Chg		% Chg		% Chg		% Chg	
	Actual	Year Ago	Interim Estimate	Year Ago	Interim Estimate	Year Ago	Interim Estimate	Year Ago
Motor Fuels	392.1	7.6	137.9	9.1	530.0	8.0	277.2	4.1
Motor Vehicle Usage	288.4	-4.5	98.8	-6.3	387.2	-5.0	198.4	-0.3
Motor Vehicle License	61.4	1.0	32.7	5.1	94.1	2.4	35.3	7.0
Motor Vehicle Operators	10.6	146.5	5.5	243.8	16.1	172.9	6.9	1.5
Weight Distance	64.1	2.7	21.3	2.9	85.4	2.8	44.1	2.8
Investment	3.1	34.8	0.7	-78.1	3.8	-30.9	4.5	246.2
Other	32.3	2.9	12.8	23.1	45.1	7.9	19.5	-1.0
Compliance Initiative							0.3	
Road Fund	852.0	2.9	309.7	3.6	1,161.7	3.1	586.2	3.0

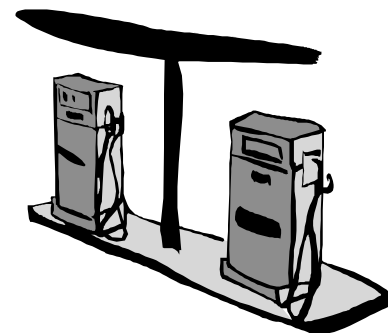
Motor vehicle usage tax collections fell 4.5 percent to \$288.4 million in the first nine months of the fiscal year and are expected to fall by 6.3 percent in the final quarter of FY06. Total FY06 collections are forecast to be \$14.0 million lower than the official revenue estimate. Growth is expected to remain slightly negative for this account in the first half of FY07. Legislation enacted by the 2006 General Assembly will raise revenues from this tax, but not by enough to completely offset the impact of declining motor vehicle sales.

To estimate the growth of all other components of the Road Fund, officials of the Kentucky Transportation Cabinet and staff of the Governor's Office for Economic Analysis together assessed recent growth patterns as well as administrative and statutory factors. Motor vehicle license taxes are forecasted to increase 5.1 percent

in the final quarter of FY06 and rise 7.0 percent in the first half of FY07. Motor vehicle operators' licenses are projected to rise by 243.8 percent in the remainder of the fiscal year due to a statutory increase in drivers' license fees from \$8 to \$20. Growth in this account will slow to 1.5 percent in the first six months of FY07. Weight distance tax revenue should improve by 2.9 percent for the remainder of the fiscal year. Growth in the account will continue into the first two quarters of FY07 with revenues growing by 2.8 percent. Investment income should decline by 78.1 percent due to lower fund balances for the remainder of FY06 but see strong growth of 246.2 percent in the following two quarters. All other revenues should combine for growth of 23.1 percent during the last three months of FY06 and fall 1.0 percent in the first half of FY07.

Table 8
FY06 Interim Road Fund Revenue Forecast
Compared to Official Estimate
(million \$)

	<u>Interim</u> <u>Estimate</u>	<u>Official</u> <u>Estimate</u>	<u>Dif</u>
Motor Fuels	530.0	528.5	1.5
Motor Vehicle Usage	387.2	401.2	-14.0
Motor Vehicle License	94.1	90.2	3.9
Motor Vehicle Operators	16.1	16.6	-0.5
Weight Distance	85.4	85.4	0.0
Investment	3.8	3.8	0.0
Other	<u>45.1</u>	<u>44.0</u>	<u>1.1</u>
Road Fund	1,161.7	1,169.7	-8.0



ECONOMIC OUTLOOK

The economic outlook presented here is for the three-quarter period from April to December 2006. In terms of fiscal years this period encompasses the final quarter of FY06 (April to June 2006) and the first half of FY07. The national outlook is based on Global Insight's March 2006 forecast, and the Kentucky outlook is from GOEA's March 2006 forecast.

National Economy

During the final quarter of FY06 the economy is expected to continue to expand at the same pace as the January-to-March quarter. Almost all indicators are strongly positive. Real GDP is forecasted to increase by 3.5 percent. Other factors like

investment, productivity, and consumer confidence show robust growth. Rapid gains in productivity and global competition had caused employment to grow slowly a year ago, but the strong

economy has changed that. Nonfarm employment is expected to be up 1.6 percent during the final quarter of FY06.

In the first half of FY07 real GDP growth is expected to moderate slightly due to high energy costs as crude oil averages \$60 per barrel. Real GDP is expected to increase by 3.2 percent compared to 3.4 percent for the same period a year ago. Employment in nonagricultural industries is forecasted

to rise by 1.4 percent during the first half of FY07, the same rate as a year ago. The consumption component of GDP has recently been the major factor in sustaining growth. During the last quarter of FY06 real consumption expenditures are projected to increase by 3.3 percent with durable goods rising by just 2.4 percent. A year ago durable goods consumption was up a robust 6.7 percent. The drag on consumption is a direct result of high fuel prices and the consequent demand for energy-saving, lower priced automobiles. Consumption growth during the first half of FY07 is expected to be 3.3 percent compared to 3.4 percent last year. The slower growth is again related to moderation in the durable goods market and the impact of high oil prices.

Investment spending has been accelerating in recent months, and the outlook is for a continuation of that trend. During the fourth quarter of FY06 investment is expected to rise by 7.5 percent and then moderate to a growth rate of 4.9 percent in the first half of FY07.

Table 9
Economic Outlook: Fourth Quarter of FY06

	FY05 Q4	FY06 Q4	Percent Change
United States			
Real GDP (billion 2000\$)	11,089.2	11,473.1	3.5%
Personal Income (billion\$)	10,185.7	10,815.1	6.2%
Nonagricultural Employment (million)	133.2	135.3	1.6%
Unemployment Rate (%)	5.1	4.7	-
Kentucky			
Personal Income (million\$)	118,623	125,239	5.6%
Nonagricultural Employment (thousand)	1,823.5	1,850.5	1.5%
Goods producing (thousand)	368.7	376.8	2.2%
Service Providing (thousand)	1,141.8	1,158.5	1.5%
Government (thousand)	313.0	315.2	0.7%

The weak dollar is expected to cause a surge in exports and at the same time put a damper on imports. The trade-weighted exchange rate is forecasted to increase by 0.4 percent during the final quarter of FY06 and drop by 4.4 percent in the first half of FY07. U.S. exports are forecasted to show gains of 6.2 percent in FY06:4, and then 7.4 percent in the first half of FY07. The corresponding import numbers are 6.6 percent and 6.7 percent.

The first three years of the upturn in the business cycle had been characterized as either a “jobless recovery” or a “job loss recovery.” Recently, however, the tide has turned and employment is on the rise. The unemployment rate is expected to slide to 4.7 percent during the fourth quarter compared to 5.1 percent a year ago. It is predicted to hover at 4.8 percent in the first half of FY07 compared to 5.0 percent in the same period a year ago. Similarly, non-farm employment is expanding. Job gains are expected to be 1.6 percent in FY06:4, followed by a gain of 1.4 percent during the first half of FY07.

State Economy

Kentucky’s economy has improved steadily during the last year. In the final quarter of FY06 personal income is estimated to increase by 5.6 percent compared to a 6.2 percent increase nationally. During the first half of FY07 personal income is expected to be up 6.2 percent, but the national average is forecasted slightly higher with an increase of 6.4 percent. The lower growth in Kentucky is due primarily to the employment mix, and the relatively slow gains in manufacturing wages.

Employment has had steady recovery during FY06.

During the first three quarters of FY06 total nonfarm employment in Kentucky was up by 1.6 percent. In the same period a year ago employment had shown a gain of 1.1 percent. A combination of factors is expected to keep nonfarm employment growth at 1.5 percent in the final quarter of the year, followed by a slight slowdown to 1.3 percent in the first half of FY07. These factors are related to the decline in the U.S. dollar, the rise in coal production, and a slowdown in business services.

Employment in goods-producing industries had declined dramatically in Kentucky in response to productivity gains and the shift of some manufacturing facilities abroad. However, the lower dollar and increased consumer demand are expected to result in gains in the next three quarters. During the fourth quarter of FY06 employment in the goods-producing sector is expected to be up 2.2 percent. Then, during the first half of FY07, as manufacturing recovers, employment in the goods producing sector is expected to be up 2.4 percent.

Service-providing industries are forecasted to do well during the fourth quarter of FY06 with an addition of 16,700 jobs. The growth rate during the first half of FY07 is expected to be 1.1 percent.

Table 10
Economic Outlook: First Half of FY07

	FY06 Q1 & Q2	FY07 Q1 & Q2	Percent Change
United States			
Real GDP (billion 2000\$)	11,225.0	11,581.4	3.2%
Personal Income (billion\$)	10,369.1	11,037.7	6.4%
Nonagricultural Employment (million)	134.0	135.8	1.4%
Unemployment Rate (%)	5.0	4.8	-
Kentucky			
Personal Income (million\$)	120,316	127,768	6.2%
Nonagricultural Employment (thousand)	1,831.5	1,855.7	1.3%
Goods producing (thousand)	368.7	377.4	2.4%
Service Providing (thousand)	1,148.2	1,161.2	1.1%
Government (thousand)	314.6	317.1	0.8%

APPENDIX

Kentucky State Government Revenue - General Fund Revenue

	Third Quarter 2005 - 2006	Third Quarter 2004 - 2005	% Change	Year-To-Date 2005 - 2006	Year-To-Date 2004 - 2005	% Change
TOTAL GENERAL FUND	1,854,460,967	1,780,336,060	4.2%	\$6,008,847,946	\$5,503,937,430	9.2%
Tax Receipts	1,787,400,335	1,728,988,139	3.4%	\$5,794,874,544	\$5,277,728,917	9.8%
Sales and Gross Receipts	795,572,112	720,637,236	10.4%	\$2,352,181,007	\$2,094,391,653	12.3%
Beer Consumption	1,424,158	1,434,010	-0.7%	4,709,968	4,723,891	-0.3%
Beer Wholesale	10,142,141	8,396,490	20.8%	33,315,882	27,971,407	19.1%
Cigarette	41,907,439	3,959,506	958.4%	127,954,993	11,873,523	977.6%
Cigarette Floor Stock	(23,948)	0	---	12,096,847	0	---
Distilled Spirits Case Sales	24,008	22,939	4.7%	70,704	68,301	3.5%
Distilled Spirits Consumption	2,449,734	2,318,491	5.7%	7,421,468	6,775,229	9.5%
Distilled Spirits Wholesale	6,058,379	4,559,092	32.9%	17,419,250	13,346,325	30.5%
Insurance Premium	45,069,518	48,953,876	-7.9%	83,878,368	84,882,947	-1.2%
Pari-Mutuel	551,774	580,676	-5.0%	2,842,135	1,983,536	43.3%
Race Track Admission	3,575	8,401	-57.4%	185,739	162,802	14.1%
Sales and Use	684,585,740	647,808,281	5.7%	2,053,055,512	1,935,010,543	6.1%
Wine Consumption	574,014	540,859	6.1%	1,397,058	1,764,801	-20.8%
Wine Wholesale	2,805,580	2,054,615	36.6%	7,833,084	5,828,349	34.4%
Telecommunications Tax	0	---	---	0	0	---
License and Privilege	143,346,129	153,208,433	-6.4%	\$306,667,568	\$292,851,939	4.7%
Alc. Bev. License Suspension	63,300	52,251	21.1%	161,950	156,101	3.7%
Coal Severance	57,810,692	43,712,535	32.3%	163,249,282	130,721,507	24.9%
Corporation License	9,689,749	35,469,547	-72.7%	40,819,720	67,436,867	-39.5%
Corporation Organization	36,358	11,327	221.0%	173,569	69,671	149.1%
Occupational Licenses	23,760	23,042	3.1%	69,596	104,330	-33.3%
Oil Production	1,473,422	1,112,401	32.5%	4,680,805	3,354,256	39.5%
Race Track License	4,200	3,850	9.1%	265,275	267,100	-0.7%
Bank Franchise Tax	58,216,380	62,989,331	-7.6%	58,859,204	62,996,572	-6.6%
Driver License Fees	139,637	123,282	13.3%	436,934	395,072	10.6%
Minerals Severance	2,653,185	2,550,206	4.0%	11,373,901	10,176,385	11.8%
Natural Gas Severance	13,235,446	7,160,661	84.8%	26,577,333	17,174,078	54.8%
Income	707,239,601	700,571,502	1.0%	\$2,628,796,282	\$2,395,552,482	9.7%
Corporation	115,827,798	40,392,459	186.8%	522,918,089	254,665,114	105.3%
Individual	591,411,802	660,179,043	-10.4%	2,105,878,193	2,140,887,368	-1.6%
Property	\$119,855,326	\$130,047,952	-7.8%	\$444,809,938	\$421,639,735	5.5%
Bank Deposits	496,163	468,790	5.8%	503,204	468,790	7.3%
Building & Loan Association	193,176	0	---	241,498	71,384	238.3%
Distilled Spirits	3,693	300,490	-98.8%	406,835	388,259	4.8%
General - Intangible	7,211,602	6,181,242	16.7%	30,715,268	26,479,562	16.0%
General - Real	63,280,790	58,120,454	8.9%	208,386,186	194,730,084	7.0%
General - Tangible	43,810,926	41,403,127	5.8%	135,188,784	128,210,677	5.4%
Omitted & Delinquent	1,904,872	8,177,192	-76.7%	19,720,600	19,538,771	0.9%
Public Service	2,955,391	15,392,159	-80.8%	49,644,837	51,727,212	-4.0%
Other	(1,286)	4,497	-128.6%	2,727	24,993	-89.1%
Inheritance	\$12,868,890	\$16,650,971	-22.7%	\$36,362,503	\$48,323,847	-24.8%
Miscellaneous	\$8,518,277	\$7,872,045	8.2%	\$26,057,246	\$24,969,261	4.4%
Legal Process	6,063,148	5,672,663	6.9%	18,785,835	18,554,336	1.2%
T. V. A. In Lieu Payments	2,403,178	2,181,146	10.2%	7,044,076	6,377,876	10.4%
Other	51,951	18,236	184.9%	227,334	37,048	513.6%
Nontax Receipts	\$66,971,037	\$49,531,441	35.2%	\$208,848,635	\$221,788,694	-5.8%
Departmental Fees	6,452,841	5,905,096	9.3%	17,865,161	16,965,140	5.3%
PSC Assessment Fee	1,908	3,931	---	8,780,069	11,112,299	-21.0%
Fines & Forfeitures	6,571,658	6,204,885	5.9%	19,612,245	19,047,648	3.0%
Interest on Investments	327,996	196,208	67.2%	870,654	636,422	36.8%
Lottery	51,000,000	33,000,000	54.5%	128,000,000	119,752,000	6.9%
Sale of NOx Credits	990,000	356,250	177.9%	1,126,000	3,586,675	-68.6%
Miscellaneous	1,626,635	3,865,072	-57.9%	32,594,505	50,578,510	-35.6%
Redeposit of State Funds	\$89,595	\$1,816,480	-95.1%	\$5,124,767	\$4,419,819	15.9%

Kentucky State Government Revenue - Road Fund Revenue

	Third Quarter 2005 - 2006	Third Quarter 2004 - 2005	% Change	Year-To-Date 2005 - 2006	Year-To-Date 2004 - 2005	% Change
TOTAL ROAD FUND	\$282,974,714	\$285,118,807	-0.8%	\$851,961,705	\$827,687,276	2.9%
Tax Receipts-	\$274,581,733	\$277,594,937	-1.1%	\$828,942,597	\$805,428,653	2.9%
Sales and Gross Receipts	\$215,225,763	\$221,392,318	-2.8%	\$680,549,590	\$666,480,387	2.1%
Motor Fuels Taxes	118,307,427	115,321,295	2.6%	373,788,811	349,807,669	6.9%
Motor Fuels Use & Surtax	7,433,139	5,671,462	31.1%	18,039,479	14,257,930	26.5%
Truck Trip Permits (fuel)	98,640	100,065	-1.4%	285,920	337,645	-15.3%
Motor Vehicle Usage	89,386,557	100,299,496	-10.9%	288,435,380	302,077,144	-4.5%
License and Privilege	\$59,355,970	\$56,202,619	5.6%	\$148,393,007	\$138,948,266	6.8%
Motor Vehicles	28,400,056	29,452,845	-3.6%	61,406,790	60,791,107	1.0%
Motor Vehicle Operators	3,860,645	1,295,008	198.1%	10,632,042	4,326,654	145.7%
Weight Distance	21,248,030	20,784,846	2.2%	64,131,628	62,397,140	2.8%
Truck Decal Fees	123,339	(580,497)	---	199,009	229,975	-13.5%
Other Special Fees	5,723,901	5,250,416	9.0%	12,023,538	11,203,390	7.3%
Nontax Receipts	\$7,810,249	\$6,813,675	14.6%	\$21,493,316	\$21,171,157	1.5%
Departmental Fees	4,031,062	4,298,799	-6.2%	12,252,431	12,879,111	-4.9%
In Lieu of Traffic Fines	328,092	317,203	3.4%	944,044	1,012,086	-6.7%
Highway Tolls	1,505,087	1,492,000	0.9%	4,677,131	4,605,743	1.5%
Investment Income	1,802,870	601,112	199.9%	3,138,538	2,325,742	34.9%
Miscellaneous	143,138	104,561	36.9%	481,172	348,474	38.1%
Redeposit of State Funds	\$582,732	\$710,195	-17.9%	\$1,525,792	\$1,087,466	40.3%

1 *Executive Summary*

3 *Revenue Receipts - Third Quarter 2006*

7 *The Economy*

11 *Interim Outlook*

17 *Appendix: Third Quarter Receipts*
